IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

IN RE:	:	Chapter 7
CITX CORPORATION, INC.	:	USDC BKY EDPA
	:	NO. 01-19604
Debtor	:	
GARY SEITZ, CHAPTER 7 TRUSTEE	:	
FOR CITX CORPORATION, INC.	:	Adversary No. 03-727
	:	
	:	
Plaintiff,	:	
v.	:	
	:	United States District Court for EDPA
DETWEILER, HERSHEY AND	:	Misc. NO. 03-cv-6766
ASSOCIATES, P.C. AND	:	
ROBERT SCHOEN, CPA	:	
	:	
Defendants.	:	

MEMORANDUM

Giles, C.J. December 8, 2004

I. Introduction

This action arises from the bankruptcy of the CitX Corporation ("CitX"), filed on July 3, 2001. Plaintiff, Gary Seitz, was appointed Trustee of CitX on September 25, 2001. On July 2, 2003, Plaintiff brought an adversary action against the accounting firm of Detweiler, Hershey and Associates and Robert Schoen (collectively "Defendants") alleging malpractice (Count I), deepening insolvency (Count II), breach of fiduciary duty (Count III), and negligent misrepresentation (Count IV). (Pl.'s Compl. at 9-11.) The bankruptcy court dismissed the breach of fiduciary claim by order on November 25, 2003. Before this court is Defendants' unopposed Motion for Partial Summary Judgment as to Counts I and IV. For the reasons that follow, the Defendants' Motion for Partial Summary Judgment is granted.

II. Factual Background

CitX was formed on or about August 12, 1996 for the purposes of providing internet and software consulting services to businesses and other entities worldwide. During the same year, CitX retained Defendants to provide accounting services. (Pl.'s Compl. ¶ 6.) The terms and conditions of the relationship between CitX and the Defendants were outlined in a January 7, 2000 engagement letter ("Engagement Letter") between Defendants and CitX's President, Bernie Roemmele. The Engagement Letter provided that Defendants would "compile" from information provided by CitX "the annual statements of assets, liabilities and equity . . . for the years ended June 30, 1999 and 1998." (Engagement Letter ¶ 1.) The letter specifically notes that Defendants "will not audit or review such financial statements" provided by CitX. (Id.) The Engagement Letter specifies that the Defendants' "engagement cannot be relied upon to disclose errors, irregularities, or illegal acts, including fraud or defalcations, that may exist," but that the Defendants would inform CitX "of any such matters that come to our attention." (Id.)

During the course of its engagement with CitX, Defendants provided three compiled financial statements. The first compiled financial statement was issued on July 17, 1998 and covered the period between June 30, 1997 and June 30, 1998. The second compiled financial statement was issued on January 7, 2000 and covered the period between June 30, 1998 and June 30, 1999. The final compilation issued on January 7, 2000 provided an interim report for June 30, 1999 to December 31, 1999. Each report contained a cover letter reiterating the nature and purpose of the compiled financial statement. The cover letter states that Defendants have "compiled" the assets, liabilities, and equity of CitX in accordance with generally accepted accounting principles. (Cover Letter ¶ 1.) The cover letter continues to explain:

> compilation is limited to presenting in the form of financial statements and supplementary schedules information that is the representation of management. We have not audited or reviewed the accompanying financial statements and supplementary schedule and, accordingly, do not express an opinion or any other form of assurance on them. (Cover Letter ¶ 2.)

The first and third reports also contain a notion that "Management has elected to omit substantially all of the disclosures ordinarily included in financial statements," which, if disclosed "might influence the user's conclusions about the Company's assets, liabilities, equity, revenues, and expenses." (Cover Letter ¶ 3) (emphasis added).

On July 3, 2001, CitX filed a voluntary petition for bankruptcy. Plaintiff was appointed Trustee of CitX on September 25, 2001. On July 2, 2003 he brought a four count adversary action against Defendants which included the claims for malpractice and negligent misrepresentation at issue here. Plaintiff alleges that Defendants "knew or should have known of the lack of accounting skills at CitX and the lack of internal controls" thus subjecting Defendants to "heightened duties" in regards to their relationship with CitX. (Pl.'s Compl. ¶ 9.) Plaintiff alleges that Defendants' review of CitX's bank accounts during their engagement "would have revealed that CitX was routinely issuing checks that bounced and that their accounts were first periodically overdrawn and later routinely overdrawn." (Pl.'s Compl. ¶ 13.) These bounced checks, argue the Plaintiff, put Defendants "on notice of financial problems at CitX." (Pl.'s Compl. ¶ 15.) According to Plaintiff, given Defendants' alleged knowledge of accounting irregularities, the Defendants "were obligated to ensure that the statements were materially accurate and had an enhanced duty to inquire more deeply into the financial affairs of CitX." (Pl.'s Compl. ¶ 22.) Plaintiff alleges that Defendants conduct fell below the general standard of professional care owed by accountants to their clients, thus constituting professional malpractice.

(Pl.'s Compl. ¶ 37.) Similarly, the Plaintiff alleges that these facts demonstrate that Defendants negligently prepared materially inaccurate financial statements, which they knew or should have known would be relied upon by CitX and third parties, and that this reliance was justified, resulting in Defendants' negligent misrepresentation. (Pl.'s Compl. ¶ 46-48.)

In their motion for partial summary judgment, Defendants contend that Plaintiff's claims for professional malpractice (Count I) and negligent misrepresentation (Count IV) are barred by the two-year statute of limitations for negligence claims pursuant to 42 Pa. Cons. Stat. Ann. § 5524(2) (West 2004). (Defs.' Mot. For Partial Summ. J. ¶¶ 15, 17.) The Defendants further allege that they are entitled to partial summary judgment on the fourth count, negligent misrepresentation, because the Plaintiff has failed to establish (1) a specific misrepresentation of a material fact or (2) justifiable reliance on the part of CitX. (Defs.' Mot. For Partial Summ. J. ¶¶ 23, 32.)

III. Standard for Unopposed Motion for Partial Summary Judgment

Summary judgment is appropriate "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c). See also Celotex Corp. v. Catrett, 477 U.S. 317, 322 (1986) (holding the entry of summary judgment is mandated "against a party who fails to make a showing sufficient to establish the existence of an element essential to the party's case, and on which that party will bear the burden of proof at trial."). The moving party bears the initial burden of proving that no genuine issue of material fact is in dispute. Celotex, 477 U.S. at 323; Adickes v. S.H. Kress & Co., 398 U.S. 144, 157 (1970). Once the moving party has carried this burden, the nonmoving party may not rest upon the mere allegations in its pleadings, but must set

forth specific facts demonstrating that there is a genuine issue for trial. Fed. R. Civ. P. 56(e). Although the nonmoving party is required to set forth specific facts, a moving party is not "automatically entitled to summary judgment if the opposing party does not respond." Anchorage Assoc. v. Virgin Islands Bd. of Tax Review, 922 F.2d 168, 175 (3d Cir. 1990) (quoting Jaroma v. Massey, 873 F.2d 17, 20 (1st Cir. 1989)). When a summary judgment motion is unopposed, the court must determine whether the "facts specified in or in connection with the motion entitle the moving party to judgment as a matter of law." Id. In other words, the court must determine, after viewing the evidence in a light most favorable to the nonmoving party, whether there exists no genuine issue of material fact that would permit a reasonable jury to find for the nonmoving party. Boyle v. County of Allegheny, 139 F.3d 386, 393 (3d Cir. 1998).

IV. Discussion

A. Plaintiff's Claims are Not Barred by the Two-Year Statute of Limitations Set Forth in 42 Pa. Cons. Stat. Ann. § 5524(2)

Plaintiff's claims for professional malpractice and negligent misrepresentation are both negligence claims covered under 42 Pa. Cons. Stat. Ann. § 5524. See e.g., Sch. Dist. Of Aliquippa v. Maryland Cas. Co., 587 A.2d 765, 770-71 (Pa. Super. Ct. 1991) (applying § 5524 to an accountant malpractice action); Cooper v. Sirota, No. 01-3620, 2002 WL 1331749 at *48 (3d Cir. June 18, 2002) (applying § 5524 to claim for negligent misrepresentation). Section 5524(2) provides that an action "to recover damages for injuries to the person or for the death of an individual caused by the wrongful act or neglect or unlawful violence or negligence of another" must be commenced within two years.

Generally, the statute of limitations begins to run "as soon as the right to institute and maintain a suit arises . . . ." Pocono Int'l Raceway, Inc., v. Pocono Produce, Inc., 468 A.2d 468,

471 (Pa. 1983). In other words, the statute of limitations is "triggered upon the occurrence of the alleged breach of duty." Bigansky v. Thomas Jefferson Univ. Hosp., 658 A.2d 423, 426 (Pa. Super. Ct. 1995). In this case, Plaintiff asserts that Defendants breached their professional obligations as accountants and made negligent misrepresentations to CitX in their compiled financial statements. A strict application of § 5524 in these circumstances would begin tolling the two-year statute of limitations for the first report on July 17, 1998 and the second and third reports on January 7, 2000. Under this theory, the statute of limitations expired on July 17, 2000 and January 7, 2002, respectively. As a result, the Plaintiff's claims would have expired before the commencement of the adversary proceeding on July 2, 2003. However, there is an equitable exception to a strict application of the tolling period applicable to this case.

Under Pennsylvania law, if a plaintiff, despite exercising due diligence, is unable to discover or know of the injury or its cause, the "discovery rule" exception applies to toll the statute of limitations until such time as the plaintiff discovers, or reasonably should have discovered, the injury. Pocono, 468 A.2d at 471. Determination of whether the plaintiff has or has not exercised due diligence in discovering the harm is generally a matter for the jury, making summary judgment inappropriate. Kingston Coal Co. v. Felton Mining Co., Inc., 690 A.2d 284, 288 (Pa. Super. Ct. 1997); Haggart v. Cho, 703 A.2d 522, 528 (Pa. Super. Ct. 1997). However, if the facts are so clear that reasonable minds could not "differ as to whether the plaintiff should reasonably be aware that he has suffered an injury, the determination as to when the limitations period commences may be made as a matter of law." Kingston, 690 A.2d at 288. The standard for reasonable diligence is an objective or external one, focusing on whether a reasonable person in the plaintiff's position would have been unaware of the salient facts associated with the injury and its cause. Haggart, 703 A.2d at 528.

The question of reasonable discovery is complicated by the bankruptcy of CitX and the resulting appointment of the Plaintiff as Trustee. While a strict application of the limitations period would commence at the time the Defendants issued their compiled financial statements, this would not yield an equitable result, given a practical understanding of the position and responsibilities of a bankruptcy Trustee. Although the Trustee steps into the shoes of the bankruptcy company, it is not in a position, prior to the filing of the bankruptcy action, to be aware of potential claims arising from injuries to the bankrupt company. A reasonable person in the Trustee's position could not be aware of, or reasonably be expected to discover, injuries to CitX prior to the filing of the bankruptcy petition. Therefore, the discovery rule applies to toll the statute of limitations until the filing of the bankruptcy petition on July 3, 2001, leaving the Trustee within the applicable statutory period given its filing on July 2, 2003. See Baehr v. Touche Ross & Co., 62 B.R. 793, 797 (E.D. Pa. 1986) (tolling the two-year limitation of § 5524 until the bankruptcy filing).

B. Plaintiff has Failed to Establish that Defendants Committed Professional Malpractice

Plaintiff asserts that Defendants' conduct in regards to their relationship with CitX fell below the standard for professionals in the accounting industry, resulting in a breach of their professional duty to CitX. (Pl.'s Compl. ¶ 37.) The court finds that the Defendants' conduct did not fall below the standard of care for professional accountants, thus dismissing the Plaintiff's claim for professional malpractice.

In Pennsylvania, claims for professional malpractice framed in terms of breach of professional care constitute an action for negligence sounding in tort. See Official Comm. Of Unsecured Creditors of Corell Steel v. Fishbein & Co., P.C., Civ.A.No.91-4919, 1992 WL

196768 at *5 (E.D. Pa. Aug. 10, 1992); Jack Greenberg, Inc. v. Grant Thorton L.L.P., 212 B.R. 76, 92-93 (Bankr. E.D. Pa. 1997). Accountants, like other professionals, are required to perform their services with the "skill and knowledge normally possessed by members of that profession or trade in good standing in similar communities." Restatement (Second) of Torts § 299A (1965). See also Robert Wooler Co. v. Fidelty Bank, 479 A.2d 1027, 1031 (Pa. Super. Ct. 1984) (defining the standard of care for accountants according to § 299A of the Restatement); Neuberger v. Shapiro, 110 F. Supp. 2d 373, 384 (E.D. Pa. 2000) (finding that in Pennsylvania "an accounting firm can be liable for professional negligence where it violates its duty 'to exercise the skill and knowledge normally possessed by members of that profession or trade in good standing in similar communities.'"). When, as here, the accountants have an express service contract, the scope of their duty to plaintiff is defined by the terms of contract, so long as they perform the contract like a reasonable accountant would in their position. See O'Neill v. Atlas Automobile Fin. Corp., 11 A.2d 782, 785 (Pa. Super. Ct. 1940) (holding that defendants' counterclaim against plaintiff accountants was properly dismissed by the jury because the plaintiffs acted within the parameters of their contract and did not fall below the standard of care for accountants by failing to discover that the defendants bookkeeper was acting irregularly); Restatement (Second) of Torts § 299A cmt. c (1965) (defining the scope of the accountant's undertaking by the express or implied terms of the service contract). Although the scope of the accountants' duties are defined by the contract, accountants may still breach their professional duties to their client if they encounter glaring irregularities or illegal activities–"red flags"–which they fail to disclose. See Wooler, 479 A.2d at 1032 (holding that accountant's contract disclaimers did not shield it from liability if it ignored "suspicious circumstances which would

have raised a 'red flag' for a reasonably skilled and knowledgeable accountant."); Computer Personalities Sys., Inc. v. Stockton Bates, LLP, No.01-14231DWS, 2003 WL 22844863 at *6 (Bankr. E.D. Pa. Nov. 13, 2003) (finding that despite limiting their services to a compilation, accountants maintained a duty to point out suspicious circumstances which would raise red flags for a reasonable accountant).

The terms of the Defendants' accounting services to CitX were set out in two documents--the Engagement Letter and the cover letters accompanying the three compiled financial statements. The Defendants contracted to "compile," from information provided by CitX, annual statements of CitX's assets, liabilities and equity. (Engagement Letter ¶ 1.) The Engagement Letter specifically states that the Defendants "will not audit or review such financial statements." (Id.) The Defendants told CitX that each financial report would contain information regarding the precise scope of their services:

> [a] compilation is limited to presenting in the form of financial and supplementary schedules information that is the representation of management. We have not audited or reviewed the accompanying financial statements and supplementary schedule, and accordingly, do not express any opinion or any other form of assurance on them. (Id.)

Each financial report contained a cover letter with this language.

Defendants contracted with CitX to compile the financial statements provided by CitX management. Therefore, the extent of Defendants' duty was to provide compilation services to CitX with the skill and diligence of a reasonable accountant. The primary difference between a compilation and an audit "is the degree and amount of responsibility undertaken by the accountant." Wooler, 479 A.2d at 530. "In an audited engagement, the accountant assumes

responsibility for the accuracy of the figures," in effect "warrant[ing] the reliability of the report which he prepares." Id. By contrast, in "an unaudited engagement, the accountant does not warrant and is not responsible for the ultimate accuracy of the report if the figures supplied by the client are erroneous." Id. For these reasons, a compilation is understood as "the 'lowest level of assurance' regarding an entity's financial statements," whereas an audit "provides 'the highest level of assurance.'" Otto v. Pennsylvania State Educ. Ass'n-NEA, 330 F.3d 125, 133 (3d Cir. 2003).

Defendants satisfied their duty to CitX by compiling and providing financial statements to CitX. The Plaintiff has not alleged that Defendants failed to compile adequately the financial data provided by CitX's management or that their work or conclusions fell below the standard of care expected of accountants under like circumstances. Rather, Plaintiff alleges that the Defendants had an obligation, or a heightened responsibility, to "assist with the books of original entry, maintain the general ledger [and] the fixed assets," and "to ensure that the [Defendants'] statements were materially accurate and . . . inquire more deeply into the financial affairs of CitX." (Pl.'s Compl. ¶¶ 9, 22.) However, Defendants were under no obligation to delve into the internal finances of the CitX Corporation, given that they were only hired to perform compilation services. Therefore, based upon the undisputed record before the court, the Defendants met their duties to CitX and did not commit professional malpractice.

Plaintiff alleges that Defendants had an obligation to review CitX's bank accounts and that such a review would have put Defendants on notice that CitX was "routinely issuing checks that bounced and that [CitX] accounts were first periodically overdrawn and later routinely overdrawn." (Pl.'s Compl. ¶ 13.) In other words, Plaintiff has asserted that Defendants failed to

inform CitX of these "red flags" in violation of their accountant duties. At this point, however, without an expert affidavit from Plaintiff's side as to what a reasonable accountant in the Defendants' position would have discovered during their compilation, Plaintiff has failed to establish a genuine issue of material fact for submission of any question to the jury.

C. Plaintiff has Failed to Establish Negligent Misrepresentation

The fourth count of the Complaint is a claim for negligent misrepresentation. Specifically, Plaintiff asserts that (1) the compiled financial statements were negligently prepared, (2) Defendants knew or should have known that the alleged erroneous reports would guide the decision-making of the CitX management and potential third party investors, and (3) CitX and potential third-party investors justifiably relied on the compiled financial reports issued by Defendants. (Pl.'s Compl. ¶ 46-48.) Defendants respond in their motion for partial summary judgment, that the Plaintiff has failed to identify any specific misrepresentations on the part of Defendants or establish justifiable reliance as a matter of law. (Defs.' Mot. For Partial Summ. J. ¶¶ 23, 38.) The court finds that the Plaintiff has failed to establish a genuine issue of material fact as to its claims for negligent misrepresentation.

To establish negligent misrepresentation under Pennsylvania law, a plaintiff must demonstrate:

> (1) a misrepresentation of a material fact; (2) made under circumstances in which the misrepresentor ought to have known of its falsity; (3) with the intent to induce another to act on it; and (4) which results in injury to a party acting in justifiable reliance on the misrepresentation. Bortz v. Noon, 729 A.2d 555, 561 (Pa. 1999).

To constitute a negligent misrepresentation, a party need not know that his or her words are

untrue, but rather "must have failed to make a reasonable investigation of the truth of these words." Id. See Gibbs v. Ernst, 647 A.2d 882, 890 (Pa. 1994) (same). For a claim for negligence to exist, there must first be a duty owed by one party to another. Bortz, 729 A.2d at 561. Analysis of a claim for negligent misrepresentation is quite similar to analysis of professional negligence or malpractice. Both claims turn on whether the defendant exercised a reasonable degree of care and competence in the performance of its duties. The difference between professional malpractice and negligent misrepresentation is that the latter focuses on the professional's care in obtaining and communicating information. See Woodward v. Dietrich, 548 A.2d 301, 308 n.5 (Pa. Super. Ct. 1988) (holding that a negligent misrepresentation "is a misrepresentation which arises from a want of 'reasonable care or competence in obtaining or communicating information'" (quoting Restatement (Second) of Torts § 552 (1977))). In assessing the appropriate standard of care, negligent misrepresentation claims, like professional malpractice, look to what the recipient of the information is entitled to expect in light of the circumstances of the engagement. Restatement (Second) of Torts § 552 (1977).

This court has found that as a matter of law Defendants' conduct did not fall below the standard of care and skill required by accountants by failing to discover and disclose potential irregularities in the accounting practices of CitX. Defendants were engaged to compile financial reports and specifically alerted and disclosed to CitX that their assessment of CitX's finances would be based on the figures supplied by management and should not be used or understood to give assurances as to the validity of the underlying numbers. Therefore, Plaintiff has failed to establish that a genuine issue of material fact exists for trial on the claim of negligent

misrepresentation.[1]

V. Conclusion

For the foregoing reasons, the Defendants' Motion for Partial Summary Judgment is granted. An appropriate Order follows.

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[1] This decision is further supported by Restatement (Second) of Torts § 552 illus. 3 (1977) which provides:

> XYZ Corporation seeks a credit of $100,000 from F & Co., a factoring concern. Because the latest XYZ financial statements, audited by A & Co., a partnership of certified public accountants, are dated as of the last fiscal year-end of XYZ Corporation which fell some eight months previously, F & Co., requests that A & Co. be retained to provide unaudited financial statements for the current interim period. A & Co., knowing the statements are being prepared for the consideration of F & Co. in connection with XYZ Corporation's request for the $100,000 credit, prepares financial statements from the books of the corporation without performing any tests of the accuracy of the entries themselves or respecting the transactions represented to underlie them. The statements, furnished under A & Co.'s letterhead, are labeled "unaudited" on each page and accompanied by a written representation that they have not been audited and that, accordingly, A & Co. is not in a position to express an opinion upon them. Nothing comes to the attention of A & Co. in the course of preparing the statements to indicate that they were incorrect, but because the books from which they were prepared were, unknown to A & Co., in error, the financial statements materially misstate the financial position of XYZ Corporation and its results of operations for the period subsequent to the preceding fiscal year-end. F & Co., because it extends the credit in reliance upon the statements, suffers substantial pecuniary loss. A & Co. is not subject to liability to F & Co.

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FOR THE EASTERN DISTRICT OF PENNSYLVANIA

IN RE:	:	Chapter 7
CITX CORPORATION, INC.	:	USDC BKY EDPA
	:	NO. 01-19604
Debtor	:	

GARY SEITZ, CHAPTER 7 TRUSTEE	:	
FOR CITX CORPORATION, INC.	:	Adversary No. 03-727
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Plaintiff,	:	
v.	:	
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DETWEILER, HERSHEY AND	:	Misc. NO. 03-cv-6766
ASSOCIATES, P.C. AND	:	
ROBERT SCHOEN, CPA	:	
	:	
Defendants.	:	

ORDER

AND NOW, this 8th day of December, 2004, upon consideration of the Defendants' Motion for Partial Summary Judgment pursuant to Fed. R. Civ. P. 56, it is hereby ORDERED that Defendants' Motion is GRANTED.

BY THE COURT:

S/ James T. Giles

C.J.

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to